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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1961.

No. 891

ESTATE OF MABEL K. CARTER, DECEASED, GILBERT CARTER, EXECUTOR, ESTATE OF EMMA M. VOLLRATH, DECEASED, GILBERT CARTER, EXECUTOR, GILBERT CARTER AND VIRGINIA CARTER, PATRICIA CARTER, HOWARD CARTER, SUSAN CARTER, DAVID C. CARTER AND FRANCES M. CARTER,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

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COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Eighth Circuit entered in the above-entitled case on January 18, 1962.

OPINIONS BELOW.

The opinion of the Tax Court (Supp. R. 3-24) is reported in *35 T.C. 326*. The opinion of the Court of Appeals (*infra*, Appendix A) is reported in *298 F.2d 192*.

JURISDICTION.

The judgment of the Court of Appeals was dated and entered January 18, 1962 (*infra*, Appendix B). A petition for rehearing, and motion for consideration thereof by the Court *en banc*, were denied by orders of the Court of Appeals entered March 19, 1962. Jurisdiction to review the judgment is conferred on this Court by *28 U.S.C. 1254 (1)*.

QUESTIONS PRESENTED.

The items involved in these seven consolidated income tax cases are distributions to petitioners as beneficiaries of the Mabel K. Carter Trust, which distributions were made from, and represented in each instance *pro tanto*, net proceeds of settlement of an antitrust suit by which the trustee sought recovery for destruction of Mabel K. Carter's business as an independent motion picture theatre operator, including the good will thereof. The following questions are presented for review:

(1) Whether the net proceeds of the settlement, and the trust distributions, represented long-term capital gains under *Section 1231* of the Internal Revenue Code of 1954, from involuntary conversion (destruction) of a capital asset or capital assets (Mrs. Carter's business or good will or both) held for more than six months, as contended by petitioners—or ordinary income as contended by respondent and as determined by the Tax Court and the Court of Appeals.

(2) Whether those particular distributions that were made with respect to beneficial interests in the trust that were acquired by succession or as bequests from deceased beneficiaries represented proceeds of disposition or amounts received on account of property acquired from decedents, with bases under 1954 IRC, *Section 1014*, against which proceeds or amounts the recipients thereof were entitled to offset such bases, as contended by petitioners—or "income in respect of a decedent" under 1954 IRC, *Section 691*, as contended by respondent and as determined by the Tax Court and the Court of Appeals.

STATUTES AND REGULATIONS INVOLVED.

The statutes and regulations involved, in their pertinent texts, are the following provisions of the Internal Revenue Code (IRC) of 1954 and of Treasury Department Income Tax Regulations, Code of Federal Regulations, Title 26 (26 CFR)—

IRC Section 1231 (a). GENERAL RULE.—If during the taxable year, the recognized gains on sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months.

IRC Section 1221. CAPITAL ASSET DEFINED. For purposes of this subtitle, the term "capital asset" means

property held by the taxpayer (whether or not connected with his trade or business), but does not include * * *.

IRC Section 1014. BASIS OF PROPERTY ACQUIRED FROM A DECEDENT. (a) In General.—Except as otherwise provided in this section, the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent shall, if not sold, exchanged, or otherwise disposed of before the decedent's death by such person, be the fair market value of the property at the date of the decedent's death, * * * (b) Property Acquired from the decedent.—For purposes of subsection (a), the following property shall be considered to have been acquired from or to have passed from the decedent:

(1) Property acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent; * * * (c) Property Representing Income in Respect of a decedent.—This section shall not apply to property which constitutes a right to receive an item of income in respect of a decedent under section 691.

IRC Section 691. RECIPIENTS OF INCOME IN RESPECT OF DECEDENTS.

(a) Inclusion in Gross Income.—

(1) General Rule.—The amount of all items of gross income in respect of a decedent which are not properly includible in respect of the taxable period in which falls the date of his death or a prior period * * * shall be included in the gross income, for the taxable year when received, of:

(A) the estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent; * * *

(C) the person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the amount is received after a distribution by the decedent's estate of such right.

(2) * * *

(3) Character of Income Determined by Reference to Decedent.—The right, described in paragraph (1), to receive an amount shall be treated, in the hands of the estate of the decedent or any person who acquired such right by reason of the death of the decedent, or by bequest, devise, or inheritance from the decedent, as if it had been acquired by the estate or such person in the transaction in which the right to receive the income was originally derived and the amount includible in gross income under paragraph (1) or (2) shall be considered in the hands of the estate or such person to have the character which it would have had in the hands of the decedent if the decedent had lived and received such amount. * * *

IRC Section 1001. DETERMINATION OF AMOUNT OF AND RECOGNITION OF GAIN OR LOSS.

(a) Computation of Gain or Loss.—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis * * *.

IRC Section 1016. ADJUSTMENTS TO BASIS.

(a) General Rule.—Proper adjustment in respect of the property shall in all cases be made—(1) for expenditures, receipts, losses, or other items, properly chargeable to capital account * * *.

IRC Section 7482. COURTS OF REVIEW.

(a) Jurisdiction.—The United States Courts of Appeals shall have exclusive jurisdiction to review the de-

cisions of the Tax Court, except as provided in section 1254 of Title 28 of the United States Code, in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury; * * *.

26 CFR. 1.1001-1 (c). Even though property is not sold or otherwise disposed of, gain is realized if the sum of all the amounts received which are required by *Section 1016* and other applicable provisions of subtitle A of the Code to be applied against the basis of the property exceeds such basis. * * *

26 CFR. 1.691 (a)—1. Income in Respect of a Decedent.

(b) General Definition. In general, the term "income in respect of a decedent" refers to those amounts to which a decedent was entitled as gross income but which were not properly includible in computing his taxable income for the taxable year ending with the date of his death or for a previous taxable year under the method of accounting employed by the decedent * * *. Thus, the term includes—

(1) All accrued income of a decedent who reported his income by use of the cash receipts and disbursements method;

(2) Income accrued solely by reason of the decedent's death in case of a decedent who reports his income by use of an accrual method of accounting; and

(3) Income to which the decedent had a contingent claim at the time of his death * * *.

26 CFR 1.691 (a)—2 (b) Example (5).

A owned and operated an apple orchard. During his lifetime, A sold and delivered 1,000 bushels of apples to

X, a canning factory, but did not receive payment before his death. A also entered into negotiations to sell 3,000 bushels of apples to Y, a canning factory, but did not complete the sale before his death. After A's death, the executor received payment from X. He also completed the sale to Y and transferred to Y 21,200 bushels of apples on hand at A's death and harvested and transferred an additional 1,800 bushels. The gain from the sale of apples by A to X constitutes income in respect of a decedent when received. On the other hand, the gain from the sale of apples by the executor to Y does not.

STATEMENT OF THE CASE.

A. The Facts.

The material basic or primary facts are largely if not entirely stipulated or uncontroverted. A concise statement thereof follows:

1. For some years the Liberty Theatre in Sedalia, Missouri, was operated on the first run and as the dominant theatre in that town (R. 22) by Fox Ozark Theatres Corporation as lessee for a term expiring August 31, 1940 (R. 9). The owners decided that at such expiration they themselves would operate the theatre. On September 15, 1940, Mabel K. Carter owned an undivided half interest in the Liberty Theatre property and a half interest in a partnership between herself and C. T. Sears and wife, the latter together owning the other half interest; and the partnership commenced that day the business of exhibiting motion pictures in that theatre (R. 9). Such theatre operation continued through November 7, 1940, on which date the partnership was dissolved and C. T. Sears and wife transferred their interest in the partnership and its

assets and their half interest in the theatre property to Mabel K. Carter, who, as sole owner and proprietor, continued without interruption the operation of the Liberty Theatre through May 13, 1941 (R. 9, 10), at the end of which period she was forced, by acts of film distributing companies perpetrated in violation of the antitrust laws, to cease the operation of her said business, and thus it was destroyed (R. 23-25). She did not engage thereafter in the theatre business (R. 26). One of the Fox companies took possession of the Liberty Theatre May 15, 1941 under a 10-year lease (R. 10), which subsequently was extended for an additional 10 years (R. 26) but did not operate it until the year 1945 (R. 16).

2. On October 21, 1952, Mabel K. Carter executed a written declaration of trust (Ex. 15-0; R. 10) by which she established the Mabel K. Carter Trust and vested in herself as trustee thereof, irrevocably for the benefit of named beneficiaries, including petitioners herein (except decedents' estates), herself and others, her entire claim and cause of action against the film companies under the antitrust laws. On December 9, 1952, she, as such trustee, filed in the U. S. District Court for the Western District of Missouri at Kansas City, complaint in Civil Action No. 7940 entitled *Mabel K. Carter, Trustee, v. 20th Century-Fox Film Corporation et al.*, for the purpose and with the effect of asserting said antitrust claim and cause of action, under *15 U.S.C. 15* (R. 14, 15). Mabel K. Carter died May 18, 1954 and Gilbert Carter succeeded her as trustee and as plaintiff in that suit (Supp. R. 11).

3. In March of 1955, after a series of pre-trial conferences and approximately two days of incomplete jury trial, the antitrust suit was settled, and later and accordingly was dismissed with prejudice. The parties to the suit entered into a settlement agreement (Ex. 17-Q; R. 12)

and the successor trustee executed a release (Ex. 18-R; R. 12), by the terms of which the film companies undertook to pay to the successor trustee, over a period of years, $600,000.00. Attorney fees were a little over $205,000.00, other expense about $10,500.00 and the net recovery by the trust approximately $384,000.00 (R. 26). Pursuant to the settlement agreement and release the trust received and distributed to the beneficiaries in shares reported in Form 1041 Fiduciary returns the net amounts of $105,272.56 and $127,925.20 during the taxable years 1955 and 1956, respectively (R. 10; TC Finding, Supp. R. 15).

4. Beneficiary Emma M. Vollrath died June 20, 1953, and beneficiary Mabel K. Carter died May 18, 1954. Abovesaid distributions in respect of their respective interests in the trust were made to their estates (Gilbert Carter, Executor of each) for and during the year 1955, and to their legatees for and during the year 1956 (R. 10; TC Finding, Supp. R. 15, 16). Neither of the estates or legatees claimed in their Federal income tax returns, or received the benefit of, any *IRC Section 1014* cost or basis of the beneficial interests thus acquired from decedents (R. 10; TC Statement of Issues, Supp. R. 4).

5. The complaint in the antitrust suit is a lengthy pleading (Ex. 16-P) admittedly stating a treble damage antitrust claim under *15 U.S.C. 15*, but otherwise for purposes here, according to petitioners' appraisal thereof, made up of unreliable and inconclusive allegations, some of which are set forth in the Tax Court opinion (Supp. R. 9, 10).

6. The settlement agreement (Ex. 17-Q) and release (Ex. 18-R) are lengthy documents. Parts thereof are set forth in the Tax Court opinion (Supp. R. 11-14). The agreement acknowledged the trustee's contention that

damages were "suffered" in the sum of $600,000.00 (Supp. R. 12). The release was of all claims known or unknown and of whatever character and, in paragraph 5 at page 7 thereof, stipulated that the film companies denied liability for any and all claims arising out of or in any way connected with any alleged violation of the antitrust laws of the United States.

7. The uncontroverted testimony of the successor trustee (R. 26) was that the only property the Mabel K. Carter Trust ever acquired was the claim and cause of action against the film companies under the antitrust laws and, ultimately, the proceeds of the settlement, and that such claim was the only one that figured in the settlement.

8. Transcripts (Ex. 25 and S; R. 13-15) of pre-trial and jury trial proceedings in the antitrust suit were admitted in evidence. Excerpts therefrom, said by the Tax Court and Court of Appeals to show the suit was for recovery of lost profits, appear in the Tax Court opinion (Supp. R. 18, 19). Other excerpts, claimed by petitioners to demonstrate, to the contrary and for all practical purposes that the recovery sought was for destruction of Mabel K. Carter's business, including its good will, appear in the printed record (R. 13-15). Actually or more precisely, the latter excerpts showed that the recovery sought was (1) for loss of profits during Mrs. Carter's operation of a little more than six months, November 7, 1940 through May 13, 1941, and (2) for the value of the business destroyed at the end of that period. But according to the uncontroverted testimony of the witness Chandler, a lawyer and C.P.A., his opinion, based on examination of the records and exhibits, was that even if Mrs. Carter's operation had been on the first run and free from the oppressive effect of any unlawful conspiracy under the antitrust

laws, she would not have made a profit for that short period (R. 18). The uncontroverted testimony of the witness Kluex, an officer of some of the Fox companies, based on records of the Fox Theatre operation conducted in Sedalia with the benefit of the first run, showed the motion picture theatre business there became profitable shortly after that period (R. 15, 16).

9. In the interest of economy, and as permitted by order of Chief Judge Johnsen of the Court of Appeals, the exhibits (documentary evidence) were largely omitted from the printed record and supplemental record, but were made available to that Court, and counsel were permitted to set out parts thereof in their briefs and to refer thereto in oral argument (R. 11, 12). The exhibits are being sent up to this Court, in turn, and so will be available here—although it is believed this Court will not find it necessary to refer thereto.

B. Basis for Federal Jurisdiction and How Exercised.

Tax Court jurisdiction was conferred by *1954 IRC Sections 7442, 6213 (a) and 6214 (a)*, rendered operative in this case by petitioners timely filing in the Tax Court of petitions for redetermination of Federal income tax deficiencies and for recovery of overpayments of Federal income taxes. In all of the seven consolidated cases the Tax Court sustained the Commissioner's determination of deficiencies, arrived at by treating the trust distributions as ordinary income instead of *IRC Section 1231* long-term capital gains as reported by petitioners; and denied recovery of overpayments sought by petitioners (in the four cases in which this issue was involved), rejecting petitioners' claim of entitlement to offset against the trust distributions of *IRC Section 1014* bases for beneficial interests in the trust acquired from decedents. The Court of Appeals affirmed the Tax Court decisions on both issues.

ARGUMENT.

1. The Conflict with the Durkee (6th Cir.) and Raytheon (1st Cir.) Decisions on the Ordinary Income vs. Capital Gain Issue.

The Court of Appeals sustained the Tax Court's determination that the Carter antitrust suit was for lost profits, rather than for destruction of Mrs. Carter's business or good will or both, and that the trust distributions, made from net proceeds of settlement of that suit, represented ordinary income rather than long-term capital gains from involuntary conversion of a capital asset under *I. R. C. Section 1231*. Its decision on those points conflicts with *Durkee* v. *Commissioner*, 162 F.2d 184 and *Raytheon Prod. Corp.* v. *Commissioner*, 144 F.2d 110, neither of which was discussed and both of which presumably were ignored.

In *Durkee* the Court, referring to an allegation in taxpayer's pleading in the antitrust suit that he had been deprived of income for about ten years of approximately $150,000, said, l.c. 186:

> "As was the case in *Farmers and Merchants Bank* v. *Commissioner*, *supra*, the allegations as to profits both before and after the acts complained of 'were only an evidential factor in determining actual loss and not an independent basis for recovery.'"

In *Raytheon* the Court said, l.c. 113:

> "This is not the sort of antitrust suit where the plaintiff's business still exists and where the injury was merely for lost profits. The allegations and evidence as to the amount of profits were necessary in order to establish the value of the good will and busi-

ness since it is derived by a capitalization of profits. * * * Since the suit was to recover damages for the destruction of business and good will, the recovery represents a return of capital."

Durkee and *Raytheon* involved recoveries by settlements of antitrust suits. Taxpayers there claimed the recoveries represented "non-taxable" restitution of capital. Petitioners here made no such claim (except in the sense and to the extent the trust distributions were offset by *IRC Section 1014* bases. In *Durkee* and in *Raytheon* it was determined that the cost or basis of the business or good will destroyed was zero (petitioners concede that is so in the instant cases) so that the entire net recovery represented gain in each case. But in neither *Durkee* nor *Raytheon* was taxpayer in a position to claim there was long-term capital gain from involuntary conversion, because the recovery (the second essential element of an involuntary conversion) was effected prior to the year 1942, and *Section 117 (j)* of the Internal Revenue Code of 1939, predecessor of present *Section 1231*, was added by *Section 151 (b)* of the Revenue Act of 1942 and, by *Section 101* thereof, was made operative only with respect to taxable years beginning after December 31, 1941. The two cited cases nevertheless are directly in point here, in fixing the nature of the antitrust suit and recovery and in demonstrating they were for destruction of business or good will or both, and not for lost profits.

2. Departure from Accepted and Usual Course of Judicial Proceedings by Arbitrary Mishandling of Documentary Evidence and Refusal to Consider Cited Authorities and Argument.

The Court of Appeals and Tax Court alike professed to justify their decision of the *Section 1231* long-term

capital gain vs. ordinary income issue by application of the rule that the theory or basis of the claim or cause of action asserted determines, for income tax purposes, the nature of the recovery effected; but they misapplied that rule by determining, arbitrarily and erroneously, that the Carter antitrust suit was for lost profits. Such determination was based on inadvertent, unreliable and subsequently contradicted statements of plaintiff's counsel (Supp. R. 18, 19) made in the course of pre-trial proceedings, seemingly to the effect that the Carter antitrust suit was for recovery of lost profits, which statements the Tax Court plucked from context and thereby further distorted, while deliberately and inexplicably ignoring other, later and clarifying statements of Court and counsel directly and overwhelmingly to the contrary (R. 13-15), as follows:

PRE-TRIAL CONFERENCE OF JANUARY 29, 1955.

(Transcript, Exhibit S, Pages 126 and 127.)

THE COURT: Plaintiff is not here suing for profits which she would have earned for any given period of time. The profits which that business would produce is merely evidence from which the jury, from all the other facts and circumstances shown in evidence, may ascertain and determine the value of the plaintiff's property on May 13, 1941, when she says that she was put out of business.

MR. BOATRIGHT: (Attorney for Plaintiff) You mean the value of the business on May 13. You said property.

THE COURT: The value of the business.

MR. BOATRIGHT: On May 13th.

THE COURT: Yes.

MR. BOATRIGHT: The value of the business in the absence of the conspiracy; you said it better than I have been able to say it.

PRE-TRIAL CONFERENCE OF FEBRUARY 3, 1955.

(Transcript, Exhibit S, Page 187.)

MR. BOATRIGHT: We are claiming, we have specifically limited our claim for damages to the lost profits that she suffered when she was operating after November 7, 1940, and to the value of the business, free from the conspiracy, on May 15, 1941, when she was driven out of business.

PRE-TRIAL CONFERENCE OF FEBRUARY 7, 1955.

(Transcript, Exhibit S or Exhibit 25, Pages 243 and 244).

THE COURT: I am thinking of limitation with reference to proof of operations to the period of time within the first lease. Why shouldn't a ten-year operation in Sedalia give to the jury facts from which they could make an estimate of the value of her business as of May 13 or 15, whichever it was? There would be evidence in the case, of course, that Mrs. Carter lived 14 years, but it is not actually the number of years that she lived, it is what was the value of her property at the particular time you say that she was put out of business.

JURY TRIAL, MARCH 2, 1955.

(Transcript, Exhibit S, or Exhibit 25, Pages 307-309.)

THE COURT: Gentlemen of the jury panel * * * The charge is made by her (Mrs. Carter) that by reason of the conspiracy * * * her business as a motion picture operator was destroyed * * *. She * * * seeks to recover damages * * * for profits that she lost in the actual operation of the theatre, and for the damages that she alleges was the value of her theatre business when she finally was required to give up that business.

> THE COURT: (Page 428) * * *, the situation is at pre-trial conference the claim in this case was limited to loss of profits during operation from November 7th to May 13th and for the value of the business as of that date measured by the profits which could have been earned, along with the Brookside case.

As explained by testimony of the witness Chandler (R. 17, 18), any profits Mrs. Carter might have made in the period of her operation, November 7, 1940-May 13, 1941, even in the absence of the conspiracy, would have been negligible or nil, so that the suit, as a matter of substance and practicality, was exclusively for destruction of business.

That arbitrary mishandling of the evidence by the Tax Court and the Court of Appeals constituted a clear departure from the accepted and usual course of judicial proceedings.

Another such departure is marked by the admission of the Court of Appeals that it does not follow petitioners in all parts of their argument. Several instances of its failure or refusal to consider respectable, in-point authorities cited, sound contentions made, and valid analogies and crucial distinctions drawn, are reflected in this petition. Treatment herein of the full and extensive scope of such failure or refusal would unduly prolong this petition.

3. Commissioner v. Gillette, 364 U.S. 130, Was Misconstrued and Misapplied.

Nothing short of painstaking study and incisive analysis will lead to a correct interpretation of *Commissioner v. Gillette Motor Transport, Inc.*, 364 U.S. 130, 80 S. Ct. 1497, 4 L. Ed. 2d 1617. Its features and the misapplication thereof to the instant cases by the Tax Court and Court of

Appeals are such that petitioners must dwell thereon at some length. In *Gillette* taxpayer's motor transport facilities, which had become paralyzed by a strike, during World War II, were commandeered pursuant to government directive. Compensation was awarded for the temporary (10 months) use thereof, which "use" essentially was nothing other than resumption of normal operations by the taxpayer. This Court decided that such compensation was ordinary income rather than capital gain.

The real basis and justification for the Gillette decision may be found in the rule stated in *Commissioner* v. *Southwest Exploration Co.*, 350 U.S. 308, 315, that "the tax law deals in economic realities, not legal abstractions." Viewed in the light of that rule, it is very clear that what the taxpayer received in *Gillette* was compensation for the temporary use of its property—and that, by its unmistakable nature, was rent, or ordinary income. In the instant cases, what was involved was not, as the Tax Court seemed to think (Supp. R. 20), the mere right to use property or to engage in business, and it was not the mere "interrupted use" of property as stated by the Court of Appeals; it was, as a matter of economic reality, the destruction of business. Temporary use of property is one thing, destruction thereof is quite another.

Another basis or justification, alone sufficient, for the Gillette decision is that there was no sale, exchange or involuntary conversion, so there could not have been a long-term capital gain. As this Court indicated there, 364 U.S. l.c. 135, 136, an involuntary conversion will result only from a taking of the fee, that is, the entire property or interest therein absolutely, or from a destruction thereof in whole or part. Neither of those things occurred in *Gillette*. The requisite destruction did occur here.

Clarification of *Gillette* certainly is needed for the elucidation of the lower courts. In *Gillette* this Court said, 364 U.S. l.c. 135, that the right to use is not a capital asset, but is simply an incident of the underlying property. Presumably the rule to be derived from that statement is that a capital asset must be something more than a mere incidental, abstract right, having no identity or significance apart from the specific property to which it pertains; and that any property, in order to be a capital asset, must have independent character and individual identity. Mrs. Carter's business was not a mere incident, not a mere abstract right to engage in business; it was, independently and in its own right, a capital asset of great dignity, being that particular business (including but not limited to the bundle of incidental rights that pertained to it) that she had established and in which she was engaged in Sedalia, Missouri. Many lesser, component or subservient intangibles readily have been accorded capital asset status. It hardly would be consistent to deny that station to the greatest of all intangibles, namely, a person's business, which could be defined as a complex commercial entity, established and infused with integrity by the investment and practical application of capital or labor or both, rendered dynamic by commencement of its operation, and thereby imbued with a life commensurate with its continuous or intermittent conduct.

Although, as noted above, the rule deducible from *Gillette* on the meaning of "capital asset" is not adverse to petitioners here, they will venture the suggestion that the problem here is not, and that the problem in *Gillette* was not, one of statutory construction of *IRC Section 1221*, which says that the term "capital asset" means property (with exceptions not here material). "Property" is one of the most copiously and uniformly defined and best

understood words known to the law, embracing a multitude of physical things and intangible rights and interests. What is there to "construe"? It is noteworthy that in *Midwest Motor Express, Inc.*, v. *Commissioner*, 251 F.2d 405, the facts of which were essentially like those in *Gillette*, the Court of Appeals reached the same decision, by applying the rule of practicality of economic reality and by determining there was no destruction, no involuntary conversion; and did not discuss the *Section 1221* definition —doubtless because it deemed that definition plain and unmistakable, according to the common meaning of the words employed, and considered applicable the rule stated in *82 C.J.S., Statutes, Section 322, Page 577*, as follows:

> "Where the language of a statute is plain and unambiguous there is no occasion for construction, and the statute must be given effect according to its plain and obvious meaning."

(which rule is recognized in *Yates* v. *U. S.*, 354 U.S. 298, 305) and the correlative rule that courts must not resort to extrinsic aids, such for instance as committee reports, for the purpose of construing a statute contrary to its plain terms. *Id., pages 753, 756.*

Rather, the problem in cases like *Gillette* is one the solution for which may be found in what this Court said in *Commissioner* v. *Lake*, 356 U.S. 260, in determining that *sale or exchange of oil payment rights produced ordinary* income, not long-term capital gain. At l.c. 264, after noting the Court of Appeals started from the premise that oil payments are interests in land (property, and obviously capital assets according to the plain and unmistakable meaning of the statute) this Court said:

> "We too proceed on that basis; and yet we conclude that the consideration received for these oil

payment rights * * * was taxable as ordinary income. * * *"

Continuing, at l.c. 265, 266, it observed:

> "The lump sum consideration seems *essentially* a substitute for what would otherwise be received at a future date as ordinary income. * * * The *substance* of what was assigned was the right to receive future income." (Emphasis supplied)

Then, at l.c. 267, this Court explained that the above-stated conclusion was reached by application of the rule that anticipatory assignment of a right to receive ordinary future income cannot produce capital gain.

That rule, like the rule that the nature of the claim determines the character of the recovery for income tax purposes, is a facet of the more comprehensive principle of economic reality, practicality and substance above mere form, which, as demonstrated by a line of cases including *Lake*, and *Gillette* (correctly evaluated), and earlier decisions of this Court cited therein is a great, overriding principle of income tax law that cuts through or transcends lesser or technical rules, and some well-established canons for construction or application of statutes. That principle, as so established, permits a Court to ignore a statute that is applicable to a transaction or event according to the purely technical or formal aspects thereof, and to determine its income tax consequences by looking instead to its substance, its essential character, or the practical, economic reality thereof.

Applying that principle of economic reality and practicality to the instant case, it is very clear that the anti-trust suit and recovery were not for lost profits, but were for complete destruction of a capital asset, Mrs. Carter's business including the good will thereof. In *Gillette* this

Court, 364 U.S. l.c. 135, said that had the government taken a fee in taxpayer's facilities or damaged them, the compensation doubtless would have represented gain from involuntary conversion of capital assets. *IRC Section 1221* makes no distinction between tangible and intangible property in general. Since here the intangible capital asset, which was held for more than six months, was destroyed, a reasonable conclusion to be drawn from the statement of this Court last referred to is that *Gillette* must be deemed an authority for petitioners here.

4. Good Will Concept Misconstrued and Misapplied and Decisions of This Court Neglected.

The Tax Court (Supp. R. 16, 17), with subsequent sanction of the Court of Appeals, seized on the term "good will", and said there was none; and both courts on the basis of that conclusion (coupled with their erroneous interpretation of the Gillette decision) mistakenly assumed they had disposed of the *Section 1231* issue. Although petitioners are not dependent on it, there was good will in this case.

It has been said that good will is "nothing more than the probability that the old customers will resort to the old place." *Menendez v. Holt*, 128 U.S. 514, 522. The "old place" in these cases was the Liberty Theatre. That good will inhered there, as the result of operation of the Liberty on the first run and as the leading theatre in Sedalia, was alleged in the petitions (R. 3) and was substantiated by the testimony of the witness Fulton (R. 21) coupled with that of the witness Carter (R. 22). That good will was appropriated by Mrs. Carter when she commenced her business, and became a part thereof, and it was destroyed along with that business. But in another sense there was other good will, as hereinafter explained.

Good will in its more important and practical aspect of something of value is an intangible the existence of which ordinarily is considered to be reflected in the demonstrated capacity of the business to produce net profits (beyond those representing a fair return on the physical and other working assets). However, in the final analysis it is the potential for such profits in the future on which any concept of good will is utterly dependent, for a record of past profits, however impressive, must be translated into the prospect of future profits before it can be taken to indicate the existence of good will as a valuable business intangible. And it follows, of course that the requisite prospect of future profits may be established independently, and even in the complete absence, of any past profit experience or business operation. In that sense the good will of Mrs. Carter's business was indeed valuable, and it existed at the very start of her business in the form of "positive advantages" such as were referred to in *Menendez v. Holt, supra*, at l.c. 522. She launched her business in a well-appointed theatre (R. 24) with the benefit of experienced and expert management (R. 22, 23) and shortly before commencement of a highly profitable era in the motion theatre business, as demonstrated by the testimony of the witness Kluex and the Fox records for the period 1941-1951 (R. 16) and testimony of the witness Chandler (R. 18). So the time and the circumstances were propitious, except for one thing, the conspiracy. But that factor is one which, for purposes of this litigation and for all other practical purposes, cannot be considered in detraction of the value of the business or its good will, for as a matter of law it could not be cited by the wrongdoers in abatement of the damages.

In that view, good will perhaps would be more aptly termed going concern value, though it is believed the

two terms generally are deemed interchangable. In *Consolidated Rock Products Co. v. Dubois*, 312 U.S. 510, 526, where going concern valuation was required for the purposes of a corporate reorganization, this Court said that the expectation of income was the proper criterion. Although the valuation problem there was difficult of solution, here it was completely solved by the passage of time, which accommodated the hindsight rule sanctioned in *Sinclair Refining Co. v. Jenkins Petroleum Process Co.*, 289 U.S. 689, 697-699. There this Court noted that the willing buyer-willing seller test left something to be desired, and said:

> "The law will make the best appraisal that it can, summoning to its service whatever aids it can command. * * * At times the only evidence available may be that supplied by testimony of experts * * *. But a different situation is presented if years have gone by before the evidence is offered. Experience is then available to correct uncertain prophecy. Here is a book of wisdom that courts may not neglect. We find no rule of law that sets a clasp upon its pages, and forbids us to look within."

In *Kimball Laundry Co. v. U. S.*, 338 U.S. 1, 19, this Court, referring to going concern value, said:

> "Though not capitalized and carried on the books, it is obvious that such an asset may be present even in a business losing money or at any rate not making enough to have any 'excess' income."

Here there is no problem, such as occurred in that case, of proving the value of an intangible separate and apart from the physical property, because the Carter antitrust suit and recovery were not for destruction of or damage to any physical property, but were exclusively for destruction of intangibles. Nor is there any problem here of

allocation of cost or basis between various assets, because petitioners concede that the good will here and the business of which it was a part had a basis of zero.

The above-mentioned principles and decisions of this Court were overlooked by both the courts below; and their handling of the good will concept was clearly erroneous. But good will, although it was involved here, was not essential, for if and by whatever concept found to have existed it was only a part of the greater intangible capital asset, the business to which it related.

5. Commissioner v. Glenshaw Glass Company Misconstrued and Misapplied.

The Tax Court (Supp. R. 22), presumably affirmed by the Court of Appeals on this point, decided that proceeds of settlement of the Carter antitrust suit represented, in part, punitive damages, relying for that purpose upon, and misconstruing, *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426. There this Court rejected the long-standing rule that punitive damages were tax-free. It did not decide, as the Tax Court and Court of Appeals assume, that punitive damages must be ordinary income and could not represent long-term capital gain, or that some part of the proceeds of settlement of the antitrust suit necessarily would represent punitive damages. There is no indication or presumption in the instant cases that any part of the proceeds of settlement was punitive. In the settlement agreement (Exhibits 17-Q, page 4; Supp. R. 12) it was acknowledged that the trustee contended damages were "suffered" in the sum of $600,000 (the gross settlement figure). An injured person suffers compensable damages, not punitive damages. It is the wrongdoer who "suffers" the latter. Moreover, in the release (Ex. 17-Q, R. 12), it was acknowledged the film companies denied

liability (protested their innocence). So, punitive damages were not contemplated. Indeed, the litigants themselves cannot assess or impose punitive damages. In an antitrust case the only way such damages can be realized is for plaintiff to recover a treble-damage judgment, hold it until it becomes final and then collect it. However that may be, under no conceivable theory could all the net proceeds of the settlement here be punitive damages; and if any part thereof represented *IRC Section 1231* gain, or was subject to be offset by *Section 1014* basis, the petitioners' burden of proving the Commissioner's determinations to be erroneous has been discharged.

This Court should rectify the misapplication of *Glenshaw*, and dispel the erroneous notion about it that is published by the decisions below.

6. Conflict with IRC Section 7482 (a) and U. S. v. U. S. Gypsum Company, and Misapplication of Commissioner v. Duberstein.

The Court of Appeals quotes from *Boehm* v. *Commissioner*, 326 U.S. 287, 293, the following statement:

> "And an Appellate Court is limited, under familiar doctrines, to a consideration of whether the decision of the Tax Court is in accordance with law."

That decision was entered in 1945. The above quoted rule was nullified by amendment, effective September 1, 1948, of *Section 1141 (a) IRC of 1939* (now *Section 7482 (a) IRC of 1954*), to provide, for the first time, that Tax Court decisions would be reviewed in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury--thereby making applicable to Tax Court findings of fact the "clearly erroneous" test of *FRCP Rule 52 (a)*. Although the Court

of Appeals refers to *IRC Section 7482 (a)* and the "clearly erroneous" test, it is very clear from a reading of the opinion as a whole that it disposes of the main issue in this case by applying the defunct rule quoted from *Boehm, supra*, thereby disclaiming any power to set aside or question the Tax Court's determination of any fact, and thereby deciding this case in a manner conflicting with an Act of Congress and with this Court's decision in *U. S. v. U. S. Gypsum Co.*, 333 U.S. 364. As noted in statement of the instant case, *supra*, the essential basic facts largely or entirely were stipulated or uncontroverted. But the Court of Appeals treated as a finding of fact the Tax Court's crucial determination that the antitrust suit was for lost profits rather than destruction of business. Petitioners contend that such Tax Court determination, if not solely a conclusion of law, was a determination of mixed fact and law, or an inference or a finding of ultimate fact obviously induced by an erroneous concept of law. However that may be, the determination was clearly erroneous, indeed, flagrantly so, and the product of a departure from the accepted and usual course of judicial proceedings, for reasons hereinbefore stated.

U. S. Gypsum, supra, is a leading case which, at 333 U.S. l.c. 395, explains (1) the origin of the "clearly erroneous" test of *FRCP Rule 52 (a)*, and (2) its rationale, and (3) the method of applying the test—all of which the Court of Appeals failed to heed, as is apparent from its resurrection of the defunct rule of finality of Tax Court findings of fact, and its comments upon *Commissioner v. Duberstein*, 363 U.S. 278. In the latter connection the Court of Appeals overlooked two things, first, that the "mainsprings of human conduct" and other material considerations referred to in *Duberstein* are not involved here, secondly, the absence in the instant case of the credibility

factor, as related to any critical or material evidence or issue of fact. Here for all practical purposes the Court of Appeals was free of the restraining influence of the "clearly erroneous" rule.

7. IRC Sections 691 and 1014 Were Misconstrued Below, and Present Herein Important Questions That Need to Be Settled by This Court.

IRC Section 1014 treats of the basis of property acquired from a decedent and, so far as it is applicable here, provides that the basis of such property shall be its fair market value at the date of the decedent's death.

The Court of Appeals in the last substantial paragraph of its opinion seems to say *Section 1014* is inapplicable because there was no "capital". That section refers not to "capital" but to "property". A claim or cause of action is property, as is also a beneficial interest in a trust.

The Tax Court, in the last paragraph of its opinion, says petitioners (in the four cases presenting this issue) were not entitled to use *Section 1014* basis, because "there was no involuntary conversion of a capital asset" and no "sale or exchange". That was compound error in that the Court not only was mistaken about there being no involuntary conversion of a capital asset, but it also failed to realize that neither capital asset nor involuntary conversion nor sale or exchange is essential to utilization of *Section 1014* basis. A "disposition" of "property", or something even less than that, will suffice. *IRC Section 1001* provides: "The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis * * *" and by cross references that includes Section 1014 basis. Treasury Regulations *26 CFR 1.1001-1 (c)*, state: "Even though property is not sold or otherwise disposed of, gain is real-

ized if the sum of all the amounts received which are required by *Section 1016* and other applicable provisions of subtitle A of the Code to be applied against the basis of the property exceeds such basis." *IRC Section 1016* provides: "Proper adjustment in respect of the property shall in all cases be made—(1) for expenditures, receipts, losses, or other items, properly chargeable to capital account. * * *"

The term "disposition" is very broad in its scope and can signify, for instance, extinguishment of an obligation or other property interest, as by payment, retirement or other satisfaction thereof. At least such events are contemplated in the above-quoted regulation. So, although here there was indeed an involuntary conversion of a capital asset, even had there not been, *Section 1014* basis of each of the trust interests acquired from one of the decedents would be recognizable, unless that section was inapplicable because of *subsection* (c) thereof, which reads: "This section shall not apply to property which constitutes a right to receive an item of income in respect of a decedent under *Section 691*." To determine the true import of that subsection it is necessary to analyze and consider carefully the terms used to express it. Most significant is use of the word "constitutes" as distinguished from "subsequently develops into" or "later becomes the source of"—either of which latter expressions or a similar one readily and additionally could have been employed by Congress, had it intended the meaning which thereby would have been expressed. Moreover, there was no "right" to receive anything on the critical date, of death of either of the decedents, because then the beneficial trust interest related only to a mere unliquidated claim that was contingent and uncertain both as to right and amount. Finally, even had the trust interest or the claim

then "constituted" a "right to receive" it yet did not embrace "an item of income in respect of a decedent under *Section 691*"—for reasons hereinafter stated.

That phrase is vague, and there is nothing in *Section 1014 (c)*, or in *Section 691* itself, that serves to dispel the ambiguity. So, in construing those statutes, it is proper and helpful to consider their legislative history. *Section 691* is the present, modified version of a concept that was originated by *Revenue Act of 1934, Section 42*, which added to the Internal Revenue Code the following sentence:

> "In the case of the death of a taxpayer there shall be included in computing net income for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly includible in respect of such period or a prior period."

The purpose thereof was explained in Report of House Committee on Ways and Means, page 24, as follows: The courts had held that income accrued to a decedent on the cash basis prior to his death was not income to his estate, nor was it includible in his final taxable period, so that such income had been escaping the income tax altogether.

The above-quoted sentence continued in effect until it was eliminated by *Revenue Act of 1942, Section 134*, which provided there would be no accrual of income solely by reason of a taxpayer's death, and which at the same time, in order to make sure income accrued to a decedent at the time of his death would not escape taxation, added to the Internal Revenue Code *Section 126*, which is the first version of present *Section 691*. That it was the purpose of that new section not to extend or broaden the scope of the original concept, but rather to grant relief from certain hardships it had produced, is demonstrated

by the following excerpt from the Senate Finance Committee Report thereon:

> "Since the Revenue Act of 1934 the revenue laws have contained provisions including in the income of a decedent for the period in which falls the date of his death all income accrued up to the date of his death not otherwise properly includible in respect of such period or a prior period. While such income should be subject to income tax, hardship results in many cases from including in the income of the decedent's last taxable period amounts which ordinarily would be receivable over a period of several years. This section changes the existing law by providing that such amounts shall not be included in the decedent's income but shall be treated, in the hands of the persons receiving them, as income of the same nature and to the same extent as such amounts would be income if the decedent remained alive and received such amounts."

Subsection (c) of *Section 1014* was added in the 1954 Code revision but not significantly. It did not inject any new principle into the income tax law. As was noted in the Senate Committee Report on the 1954 revision, it only "makes explicit the rule of existing law."

If there be a trend (but petitioners are not dependent on it) it is toward enlargement of the category of property qualifying for *Section 1014* basis, for in the Committee Reports referring to that section it is stated:

> "There appears to be no justification for denying some property included in a decedent's gross estate for estate tax purposes a new basis at date of death while giving this new basis in most other cases."

Doubtless qualified for *Section 1014* basis are all types of property that do not constitute rights to income accrued at decedent's death, or earned or arranged for by decedent

in his lifetime, such, for example, as compensation for personal services, accrued interest, dividends, rents and royalties and gains on sales made in decedent's lifetime with the sale proceeds being received after his death.

Considering the legislative history and the evolution of *Sections 691* and *1014* it is very clear that the "income in respect of a decedent" concept does not embrace a disputed unliquidated tort claim, contingent and uncertain as to both right of recovery and amount at the time of decedent's death. If Treasury Regulation, *26 CFR 1.691 (a)-1 (b) (3)* and *Rev. Rul. 55-463*, relied on by respondent and the courts below, say that it does, they attempt to read into the statutes something Congress has not seen fit to put there, and so to that extent are invalid. But that regulation, fairly construed, is not so purposed, for Example (5) thereof (*supra*, page 6) points out the very distinction that renders *IRC Section 691* inapplicable here. By analogy (the difference between an involuntary conversion and a sale being for this purpose immaterial) the pendency of the antitrust suit in the instant case was comparable to the negotiations for sale of the apples in the example, and the settlement of the antitrust suit was like the consummation of the apple sale.

The cases cited by the courts below on this issue are either readily distinguishable from the instant case or, correctly interpreted, are favorable to petitioners. Directly in point here is *J. R. Knowland, 29 B.T.A. 618*, in which it was decided that unliquidated claims bequeathed to taxpayer by his mother, of which there was no sale or exchange or involuntary conversion but only an extinguishment by payment of judgment recovered after the mother's death, were entitled to be treated as property with a basis under statutory provisions that were predecessors of, and for this purpose essentially the same as, *Section 1014*. The

court held that when taxpayer recovered on his claims, he made a "disposition" of them within the meaning of that word as used in sections of earlier revenue acts that later became *Section 1001* of the 1954 Code. The fact that in the instant cases the interests acquired from decedents in the unliquidated claim were equitable rather than legal is purely technical and insubstantial.

Sections 691 and *1014 (c)* are so imprecise as to call for judicial construction, and the interpretative authority is scant. Lacking, and much needed for guidance of respondent and unerring administration of those two important statutes, here and henceforth, is a decision of this Court.

CONCLUSION.

These cases involve subtile but crucial distinctions that cannot be pursued in the easy, beaten paths of the law, and that have eluded the grasp of the courts below; and they present new, abstruse and important questions of Federal law that challenge the wisdom of, and should be settled by, this Court. The departures and conflicts noted call for exercise of this Court's powers of supervision and review. It is important to both government and the great body of taxpayers to have clarified by this Court, within the scope of the issues in this case, the meaning and operation of the Internal Revenue Code sections here involved, as they are sections of frequent and wide-spread application.

Respectfully submitted.

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APPENDIX A.

United States Court of Appeals

FOR THE EIGHTH CIRCUIT

No. 16,787.

Estate of Mabel G. Carter, Deceased, Gilbert Carter, Executor, Estate of Emma M. Vollrath, Deceased, Gilbert Carter, Executor; Gilbert Carter and Virginia Carter; Patricia Carter; Howard Carter; Susan Carter; David C. Carter and Frances M. Carter.

Petitioners.

vs.

Commissioner of Internal Revenue.

Respondent.

Petition to Review Decision of the Tax Court of the United States.

[January 18, 1962.]

Before SANBORN, MATTHES and RIDGE, Circuit Judges.

RIDGE, Circuit Judge.

This is an appeal from a decision of the Tax Court (35 T.C. 326) sustaining a deficiency assessment made in respect to the several income tax returns filed by petitioners for the years 1955 and 1956.

The broad question presented is whether the amounts paid as distributions from a trust estate, which sums arose from the settlement of litigation under the

anti-trust laws (15 U.S.C.A. 15) constituted in the hands of petitioners ordinary income or capital gains. The Tax Court determined they were ordinary income and not a subject for long-term capital gains treatment under Section 1231, I.R.C. 1954 (26 U.S.C.A. 1231) as claimed by all the petitioners. That Court also ruled, as to those taxpayers who inherited beneficial interests in the trust, that they were not entitled to deduct from gross income the adjusted basis of inherited interests as claimed under Section 1014, I.R.C. 1954 (26 U.S.C.A. 1014).

From our examination of the record on appeal, which includes portions of the record made in the anti-trust litigation above mentioned, it appears that the facts as found by the Tax Court are entirely accurate and fair. Consequently, no useful purpose would be served by making any detailed statement of facts in this opinion. It is deemed sufficient to say that the theory of the claim asserted in that anti-trust litigation was apposite to that made "for loss of profits" which was sustained by this Court in similar anti-trust litigation. Cf. *Twentieth Century-Fox Film Corp.* v. *Brookside Theatre Corp.*, 194 F.2d 846 (8 Cir. 1952) cert. den. 343 U.S. 942. Further, it is apparent from the record made in the anti-trust litigation here to be considered that the claim for damages therein was singularly premised in the proposition: What would have been earned by way of profits by Mabel K. Carter during the time she would have, in all likelihood, operated the Liberty Theatre in Sedalia, Missouri, as a first-run motion picture house, from and after November 7, 1940 to sometime prior to her death on May 18, 1954, if that business had been freed from the impact of any anti-trust violation as charged.[1]

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1. Exhibit "S", transcript of pre-trial conference of February 7, 1955, referred to in Tax Court opinion; the last of several such conferences held in that litigation before commencement of the trial where the issues were congealed.

The gist of the Tax Court's opinion in this case is premised on a finding of fact and conclusion therefrom that "loss of anticipated profits" inherent in that concept was the nature and character of the claim for damages, settlement for which was made in that litigation. Such issue presented a question of fact for determination by the Tax Court. Cf. *Commissioner of Internal Revenue* v. *Duberstein*, 363 U.S. 278 (1959); *Phoenix Coal Co.* v. *Commissioner*, 231 F.2d 420 (2 Cir. 1956).

It is well-settled law that the classification for tax purposes of amounts received in settlement of litigation is to be determined by the nature and basis of action settled. *United States* v. *Safety Car & Lighting Co.*, 297 U.S. 88 (1935); *Raytheon Production Corp.* v. *Commissioner*, 144 F.2d 110 (1 Cir. 1944), cert. den. 323 U.S. 779; *Freeman* v. *Commissioner*, 33 T.C. 323 (1959); *Cullins* v. *Commissioner*, 24 T.C. 322 (1955). If it is found that such a settlement is one in respect to a claim for lost profits or partly for lost profits and partly in lieu of punitive damages such as are recoverable in anti-trust litigation, there can be no question as to their taxability as ordinary income. *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426 (1955); *Phoenix Coal Co.* v. *Commissioner*, *supra*; *Mathey* v. *Commissioner*, 177 F.2d 259 (1 Cir. 1949); *Cullins* v. *Commissioner*, *supra*. These taxpayers had the burden of proving facts essential to bring themselves within the sections of the statutes providing for capital gains treatment as claimed. *Hord* v. *Commissioner*, 143 F.2d 73 (6 Cir.); *Kessler* v. *United States*, 124 F.2d 152, 154 (3 Cir.). They also had the burden of proving what portion, if any, of the amount received in settlement of the litigation in question constituted non-taxable income. *Welch* v. *Helvering*, 290 U.S. 111; *Phoenix Coal Company* v. *Commissioner*, *supra*. This they did not do.

A mere allegation of damages to "good will" does not meet that burden.

"Neither the complaint, nor the settlement agreements, nor the releases, nor the evidence as a whole, provide a basis for making any allocation of the recovery and finding that all or part of the sum" paid in settlement of the litigation here considered "'represented a return of capital." *Culbine* v. *Commissioner*, *supra*; l.c. 328.

The contention made by petitioners that the Liberty Theatre as located in Sedalia, Missouri, had substantial good will at the time Mabel K. Carter commenced business therein; that she legally appropriated that good will to her business operations and the existence of that fact appearing in the record shows that a portion of the settlement was in part for "loss of good will," is factually without basis. It ignores the fact appearing in the anti-trust litigation that the plaintiffs therein contended that such location was leased to Fox Theatres Corporation as a consequence of the impact of the anti-trust conspiracy charge.[2] The potency of that contention in relation to the claim of damages for "loss of profits" was that Mabel K. Carter, being the owner of the building in which the Liberty Theatre was located, would, more likely than not, have continued in the theatre business at that location until her death if she had been permitted to have access to first-run motion pictures and secure such profits for herself, but that the impact of the anti-trust violation charged prevented her from making "use" of that prop-

2. Cf: *Carter* v. *Twentieth Century-Fox Film Corp.*, 127 F. Supp. 675 (D.C. W.D. Mo.) as to one aspect of such leasing and claim for damages premised thereon.

erty in her theatre business operation.[3] Such contention was within the ambit of the pleadings filed in the anti-trust litigation. At no place in the record thereof was any proffered proof made as to the "going concern value" or "good will" value, *qua* good will of the Liberty Theatre business. No evidence was adduced before the Tax Court as to those matters. *A priori* it is perceived that if that "Old Place", as petitioners denote it, had any such good will value as asserted by them, that value inhered to the theatre property and it was appropriated by Fox Theatres Corporation when that Corporation took-over and thereafter operated a first-run motion picture theatre therein. The profits "Fox" made from that operation over a period of ten years were one facet of proof relied on by plaintiff in the anti-trust litigation to establish the quantum of loss of Mrs. Carter's anticipated profits. Petitioners' contention that such proof was proffered as to the value of "destruction" and "loss of good will" sustained by Mabel K. Carter, is not supported by the record made in the anti-trust litigation.

Any damages recoverable in the anti-trust litigation in light of the foregoing, were correctly determined by the

3. At the pre-trial conference mentioned in footnote 1, *supra*, the crux and substance of the claim of right to recover loss of anticipated profits in the anti-trust litigation was stated by counsel for the plaintiff therein thus: "There will be evidence in this case that the plaintiff, Mrs. Carter, was an energetic, enterprising woman, and that when she was driven out of this business she went into another business and continued in that business to the date of her death. Now, that is a fact which the jury is entitled to know as to whether or not she would have continued in business until she died. She had the health and the strength and the desire, why wouldn't she have continued in this business which would have been ten times more lucrative than the small pittance that she got out of her work at the amusement park? She worked right up to the time of her death." pp. 246, 247.

Tax Court as being in relation to a "loss of profits" for interrupted "use" of property and not the destruction of a capital asset. Cf. *Commissioner* v. *Gillette Motor Transport, Inc.*, 364 U.S. 130 (1959); *Midwest Motor Express, Inc.*; v. *Commissioner*, 251 F.2d 405 (8 Cir.) cert. den. 358 U.S. 875. Further, it is clear from the record made in the anti-trust litigation, that the contention of damage for loss of "good will" as now asserted by petitioners was contrary to the theory of claim for "loss of profits" actually asserted in that litigation.

It is not helpful in a case such as this to merely editorialize on what constitutes "destruction" of a business venture, "capital assets" or "good will" and argue therefrom by analogy and inferences drawn from factual situations considered in other litigation, as these petitioners do. Consequently, we shall not follow them in all parts of their argument made in this appeal. As the Tax Court aptly said in *Goldsmith* v. *Commissioner*, 22 T.C. 1137, 1144 (1954):

> "The essential character of the payment is not to be determined by a mere description or designation,— the actualities of the situation must govern our decision as to the true nature of the amount received."

The essential character of the payment received in settlement of the anti-trust litigation here was factually determined by the Tax Court to be ordinary income.

> "Fact findings of the Tax Court under 1954 Internal Revenue Code, §7482 (a), 26 U.S.C.A. §7482 (a), are to be given the same weight as findings of a district court in a case tried without a jury. The Tax Court's findings of fact must stand unless clearly erroneous. This rule also applies to factual inferences from undisputed basic facts." *Miller* v. *C. I. R.*, 295 F.2d 538, 541 (8 Cir. 1961).

In *Commissioner* v. *Duberstein*, *supra*, l.c. 289, the Supreme Court said:

> "Decision of the issue presented in these cases must be based ultimately on the application of the fact-finding tribunal's experience with the mainsprings of human conduct to the totality of the facts of each case. The nontechnical nature of the statutory standard, the close relationship of it to the data of practical human experience, and the multiplicity of relevant factual elements, with their various combinations, creating the necessity of ascribing the proper force to each confirm us in our conclusion that primary weight in this area must be given to the conclusions of the trier of fact."

Therefore, this Court will not substitute its judgment for that of a Tax Court, even in a case where the facts may be stipulated or undisputed. In *Boehm* v. *Commissioner*, 326 U.S. 287, 293, it was ruled that: "The circumstance that the facts in a particular case may be stipulated or undisputed does not make (the) issue any less factual in nature. The Tax Court is entitled to draw whatever inferences and conclusions it deems reasonable from such facts. And an appellate court is limited, under familiar doctrines, to a consideration of whether the decision of the Tax Court is in accordance with law. 26 U.S.C. §1141 (c) (1), 26 U.S.C.A. Int. Rev. Code §1141 (c) (1). If it is in accordance, it is immaterial that different inferences and conclusions may fairly be drawn from the undisputed facts. *Commissioner of Internal Revenue* v. *Scottish American Investment Co.*, 323 U.S. 119, 65 S. Ct. 169, 89 L. Ed. 113." See also *Crown Iron Works Co.* v. *C. I. R.*, 245 F.2d 357, l.c. 360, 8 Cir. 1957.

We can find nothing arbitrary or excessive in the Commissioner's assessment of a deficiency against these taxpayers under the facts in this case, nor are we con-

vinced of any error, factual or legal, in the decision as reached by the Tax Court that would warrant a reversal of its decision. Since the amount received under the settlement agreement in question was factually determined by that Court to be ordinary income, there could be no involuntary conversion of a capital asset in this case within Section 1231, I.R.C. 1954.

Nor is there any ground for claiming a deduct basis for any part of such recovery under Section 1014, I.R.C. 1954 (26 U.S.C.A. 1014) as made by those taxpayers who inherited interests in the Mabel K. Carter Trust. Section 1014 (c), *supra*, provides: "This section shall not apply to property which constitutes a right to receive an item of income in respect to a decedent under Section 691." (26 U.S.C.A. 1014(c)). Petitioners admit that Section 1014, *supra*, does not apply to property which constitutes a right to receive items of income in respect to a decedent under Section 691 (a), but asserts that the section is inapplicable here because: (1) "constitute" means to compose, not "subsequently develop into", and (2) at the death of taxpayers' decedents there was no "item of income" because I.R.C. Regulation 1.691 (a) (1) (b) defines income in respect to a decedent as "amounts to which decedent was entitled as gross income"; hence they say the interest of their decedent "could not be deemed gross income" as that interest was only an unliquidated anti-trust claim. Contrary to such contention, Treasury Regulation Sec. 1.691 (a) (1)-(b) (3) provides that the term "income in respect of a decedent" includes "income to which decedent has a contingent claim at the time of his death." Under Rev. Rule 55-463:

> "Income realized by the estate of a deceased person resulting from a claim which was in process of litigation at the date of his death constitutes income

acquired by reason of the death of the decedent and, under the provisions of Section 691 of the Internal Revenue Code of 1954, is includible in its gross income in the taxable year when received."

The Section 1014 claim of deduct basis here made had this factual premise. On October 21, 1952, when the trust in question was established, the beneficiaries thereof acquired an interest in a contested unliquidated claim as to which Mabel K. Carter asserted profits would have accrued to her but for certain conduct in violation of the anti-trust laws of the United States. That claim was wholly as to the loss of anticipated profits. Such a claim was not shown to have been made in respect to any "capital" attributable to any business conducted by Mabel K. Carter. It, therefore, was not "capital" on the date the trust was established nor on the date of Mabel K. Carter's death. A claim so manifestly contingent and indefinite as to lack any quality of "capital" cannot have that quality before the time it came into existence. It did not come into existence until it was received in respect to a settlement of litigation to which these taxpayers' decedents prior thereto only "had a contingent claim at the time of (their) death." Under Section 691, I.R.C. 1954 and Treasury Regulation of Income Taxes (1954 Code) Section 1.691 such proceeds were required to be considered in the hands of the person ultimately receiving them, in the same character which (they) would have had in the hands of the decedent if the decedent had lived and received such amounts." Section 691 (a) (3), I.R.C. 1954 (26 U.S.C.A. 691 (a) (3)). Cf. *O'Daniel's Estate* v. *Commissioner*, 173 F. 2d 966 (2 Cir. 1949); *Ullman* v. *Commissioner*, 34 T.C. 1107 (1960).

The decision of the Tax Court in this case is affirmed.

A true copy.

Attest:

Clerk, U. S. Court of Appeals, Eighth Circuit.

APPENDIX B.

Judgment.

United States Court of Appeals

FOR THE EIGHTH CIRCUIT.

No. 16,787. September Term, 1961.

Estate of Mabel K. Carter, Deceased, Gilbert Carter, Executor, Estate of Emma M. Vollrath, Deceased, Gilbert Carter, Executor: Gilbert Carter and Virginia Carter; Patricia Carter; Howard Carter; Susan Carter; David C. Carter and Frances M. Carter. Petitioners, vs. Commissioner of Internal Revenue.	Petition to Review Decision of the Tax Court of the United States.

This Cause came on to be heard on the Petition to Review the Decisions of the Tax Court of the United States entered January 6th, 1961, determining that there is a deficiency in the income taxes of Petitioners for the years 1955 and 1956, and was argued by counsel.

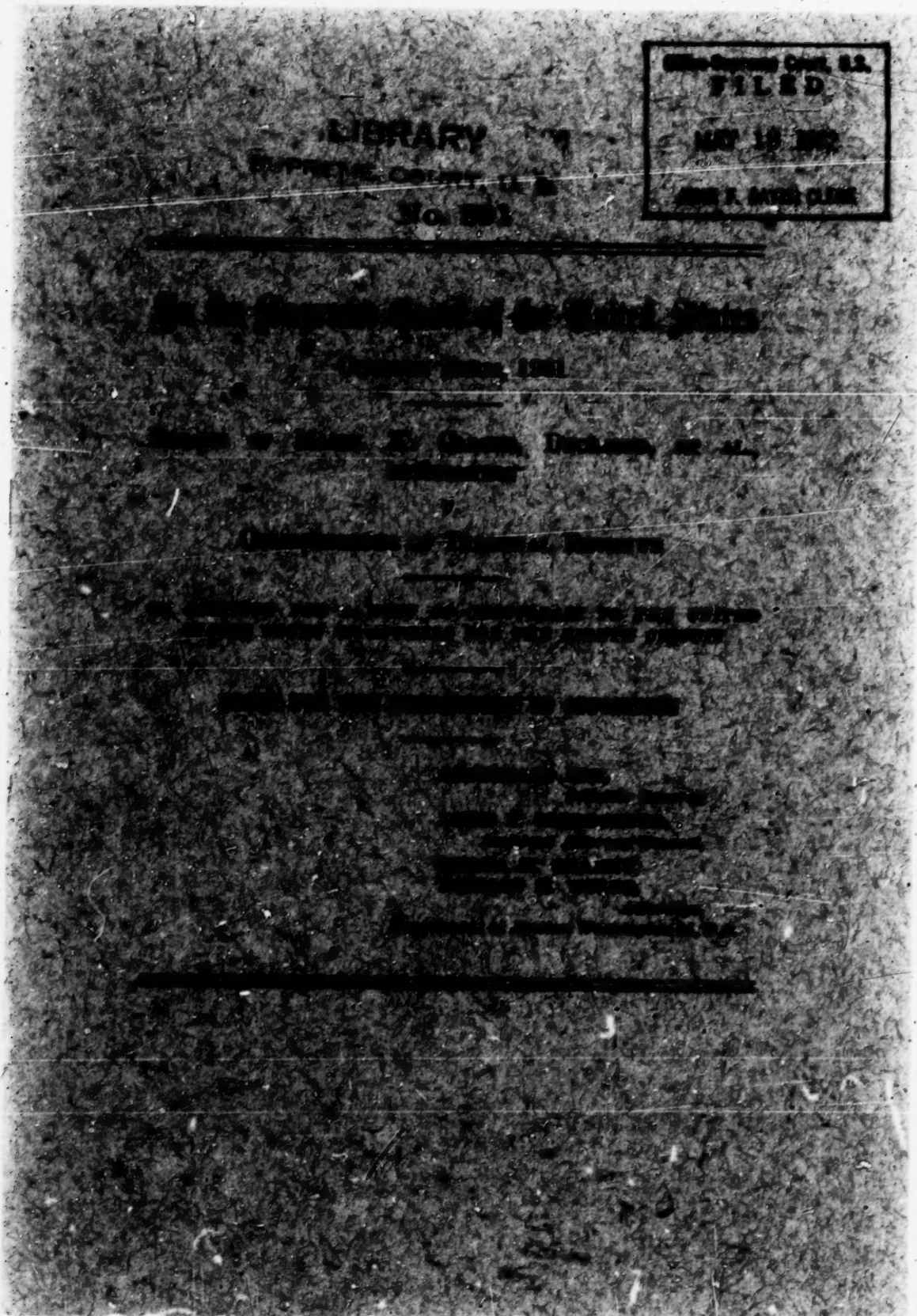
On Consideration Whereof, It is now here Ordered and Adjudged by this Court that the decisions of The Tax Court in this cause be, and the same are hereby, affirmed.

And it is further Ordered by this Court that the Petition to Review in this cause be, and the same is hereby, dismissed.

January 18th, 1962

Approved for the Court:

Robert C. Tucker,
Clerk, U. S. Court of Appeals
for the Eighth Circuit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In the Supreme Court of the United States

OCTOBER TERM, 1961

No. 891

ESTATE OF MABEL K. CARTER, DECEASED, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (Supp. R. 3-24) are reported at 35 T.C. 326. The opinion of the court of appeals (Pet. A1-A9) is reported at 298 F. 2d 192.

JURISDICTION

The judgment of the court of appeals was entered on January 18, 1962 (Pet. A10-A11). On March 19, 1962, the court denied the petition for rehearing and motion for consideration of the petition by the court *en banc*. The petition for a writ of certiorari was filed on April 19, 1962. The jurisdiction of this Court is invoked under 28 U.S.C. 1254.

QUESTIONS PRESENTED

Taxpayers received, as distributions from a trust, certain sums which the trust had received in settlement of an anti-trust suit. The questions presented are:

1. Whether the court below erred in affirming the Tax Court's determination that the settlement proceeds represented damages for loss of profits (taxable as ordinary income) rather than proceeds from the involuntary conversion of capital assets (taxable as capital gain under Section 1231 of the Internal Revenue Code of 1954).

2. Whether the courts below erred in holding that the two taxpayers who received portions of the settlement proceeds through inheritance of beneficial interests in the trust had no adjusted basis under Section 1014 to be deducted from the settlement proceeds.

STATUTE AND REGULATIONS INVOLVED

The pertinent portions of Sections 691, 1014, and 1231 of the Internal Revenue Code of 1954 and Sections 1.691(a)-1, 1.691(a)-2, 1.691(a)-3, and 1.691(a)-4 of the Treasury Regulations on Income Tax (1954 Code) appear in the Appendix, *infra*, pp. 11-19.

STATEMENT

Mabel K. Carter owned the Liberty and Sedalia Theatres in Sedalia, Missouri, and engaged in the business of exhibiting motion pictures at the Liberty Theatre between September 15, 1940, and May 14,

1941.[1] On the latter date she ceased operation, because the business was suffering losses, and leased the two theatres to the Fox Ozark Theatre Corporation (R. 9–10; Supp. R. 6).

On October 21, 1952, Mabel K. Carter executed a trust instrument in which she irrevocably assigned to herself as trustee all of her claims, rights, and causes of action under the anti-trust laws against major motion picture companies. Under the trust she, Emma M. Yollrath, and the surviving individual taxpayers acquired vested beneficial interests in the property, corpus, and income of the trust in specified percentages (R. 10; Supp. R. 6–8).

On December 9, 1952, Mabel K. Carter, as trustee, filed a complaint in the United States District Court for the Western District of Missouri against certain motion picture manufacturing and distributing companies, seeking treble damages under "Section 4 of * * * the Clayton Act." The complaint alleged many acts of the defendant motion picture companies in violation of the anti-trust acts and sought to recover damages suffered by Mabel K. Carter as owner and operator of the Sedalia and Liberty Theatres. Among other things, the complaint alleged that, because of activities of the defendants and their co-conspirators, Mrs. Carter suffered operating losses, was unable to sell or lease her properties at a fair price, and was compelled to give up

[1] Prior to November 7, 1940, Mrs. Carter owned an undivided one-half interest in the theatres and operated them in partnership with the other owners; thereafter she was the sole owner and operator (R. 9–10; Supp. R. 6).

her right to operate the theatre business "and to thus earn the reward and profits which said business and properties were capable of earning and producing and which, except for such unlawful conduct of defendants and their co-conspirators would have been earned and received by her." With respect to damages, the complaint alleged that "the business and property consisting of said Liberty Theatre and Sedalia Theatre, in Sedalia, Missouri, has been greatly injured and damaged by reason of which plaintiff has lost income, profits, business, property and investments in at least the sum of $500,000.00." Accordingly, the plaintiff trust asked judgment against the defendant motion picture companies in the amount of $1,500,000, together with attorneys' fees, costs and expenses (Supp. R. 9–10).

At the pre-trial proceedings the plaintiff's claim for damages in the anti-trust suit was explained as being limited to profits lost by reason of the defendants' action (Supp. R. 18–19). When Mabel K. Carter died, Gilbert Carter succeeded her as trustee of the Mabel K. Carter Trust and as plaintiff in the anti-trust suit.[2] On March 31, 1955, he executed an "Agreement" and "Release" which stated that the anti-trust suit was being settled for $600,000, with payment to be made over a number of years (R. 10; Supp. R. 11–13). In accordance with the settlement, he received, as trustee of the Mabel K.

[2] Mabel K. Carter died on May 18, 1954, and Emma M. Vollrath died on June 20, 1953. On July 7, 1954, the Probate Court for Vernon County, Missouri, granted letters testamentary in the Estate of Mabel K. Carter and the Estate of Emma M. Vollrath to Gilbert Carter (R. 7; Supp. R. 5).

Carter Trust, net amounts of $105,272.56 and $127,925.20 during the taxable years 1955 and 1956, respectively, which he distributed to the beneficiaries of the trust (R. 10; Supp. R. 15).

In 1956, one of the taxpayers, David Carter, succeeded to all of Emma M. Vollrath's interest and to one-fourth of Mabel K. Carter's interest under their respective wills. In 1956 he received from the trustee distributions in respect of the interests he acquired from Emma M. Vollrath and Mabel K. Carter, as well as the interest he already owned (R. 10-11; Supp. R. 15). In 1956 Gilbert Carter succeeded to one-fourth of Mabel K. Carter's interest in the trust. During that year he received from the trustee distributions in respect of the interest he acquired from Mabel K. Carter and the interest he already owned (R. 11; Supp. R. 15–16).

ARGUMENT

The primary issue here involves a question of fact on which the concurrent findings of the two courts below are final. *Comstock* v. *Group of Investors*, 335 U.S. 211, 214. Contrary to taxpayers' assertions, there is no conflict of decisions or other reason for further review of the case by this Court.

1. The two courts below found that the settlement proceeds of the anti-trust suit represented damages for loss of profits which was taxable as ordinary income. Taxpayers, on the other hand, contend (Pet. 12–25) that the proceeds resulted from the involuntary conversion of capital assets, taxable as capital gain under Section 1231 of the 1954 Code (see *infra*, pp. 13–14).

a. It is well established that the taxability of the proceeds of a lawsuit depends on what the proceeds represent. *E.g., United States* v. *Safety Car Heating Co.*, 297 U.S. 88; *Durkee* v. *Commissioner*, 162 F. 2d 184 (C.A. 6); *Raytheon Production Corp.* v. *Commissioner*, 144 F. 2d 110 (C.A. 1), certiorari denied, 323 U.S. 779. The latter two decisions hold that if the settlement proceeds in an anti-trust action represent restitution for loss of profits, they are taxable, and, if they represent restitution for loss of capital, such as for the destruction of or injury to the good will of a business, they are not taxable except to the extent that the amount of the proceeds exceeds the cost of the asset. Those propositions, despite the taxpayers' contentions to the contrary (Pet. 12–13), are not in dispute in the present case. Taxpayers concede that the settlement proceeds were taxable (Supp. R. 19) and that "the good will here and the business of which it was a part had a basis of zero" (Pet. 23–24). The issue in this case, which is analogous to that in *Durkee* and *Raytheon Production Corp.*, is whether the settlement proceeds, as a matter of fact, represented loss of profits and were therefore taxable as ordinary income or represented the conversion of a capital asset within the meaning of Section 1231 (*infra*, pp. 13–14) and were therefore taxable as capital gain.

b. On this factual question the determination of the two courts below is clearly correct. The evidence shows, indisputably, that the claim for damages in the anti-trust suit was based on profits lost by Mrs. Carter and, therefore, that the settlement proceeds represented recovery of lost profits (and perhaps punitive

damages") (see Supp. R. 9–10, 18–19). Taxpayers have not seriously denied this. Their claim has been (see Supp. R. 19–21; Pet. A4) that loss of profits was merely the measure of damages for the destruction of Mrs. Carter's theatre business, meaning the good will of the business. But the Tax Court found, and properly so on the evidence, that Mrs. Carter's "going business" of operating her theatres had not been profitable and never acquired any good will or value as an operating enterprise (Supp. R. 16, 21–22). The court of appeals concurred (Pet. A4–A5), stating (Pet. A5) that no evidence was offered in the anti-trust suit or before the Tax Court "as to the 'going concern value' or 'good will' value, *qua* good will of the Liberty Theatre business."[3]

2. The taxpayers, who inherited interests in the Mabel K. Carter Trust, claim (Pet. 27–32) that they were entitled to an adjusted basis which they could deduct from the settlement proceeds they received. This contention, which involves the application of

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[3] Taxpayers argue (Pet. 24–25) that punitive damages are not involved here. Neither court below affirmatively held that they were; they merely recognized the proposition that any portion of the proceeds which represented punitive damages was taxable as ordinary income. *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426.

[4] Contrary to taxpayers' assertion (Pet. 25–27), they were not denied proper appellate review of the Tax Court's decision. The opinion below follows the principles set forth in *Commissioner* v. *Duberstein*, 363 U.S. 278 (Pet. A6–A8). The court found no error "factual or legal" which would warrant reversal (Pet. A8) and from its examination of the record concluded that "the facts as found by the Tax Court are entirely accurate and fair" (Pet. A2). Both courts below examined the pertinent evidence in detail.

Sections 1014 and 691 of the 1954 Code (Appendix, *infra*, pp. 11–13), is also without merit.

Although Section 1014(a) provides that the basis of inherited property shall be its fair market value at the decedent's death, subsection (c) of that section expressly states that the section does not apply "to property which constitutes a right to receive an item of income in respect of a decedent under section 691." The latter section provides that the amount of all items of gross income in respect of a decedent which are not properly includible in the taxable period of death or a prior period shall be included in the gross income of the estate or heir for the taxable period when received. Section 691 further provides that the right to receive such an item of income shall be treated as having the same character in the hands of the estate or heir as it would have had in the hands of the decedent if the decedent had lived and received such amount. Since there is no question that the settlement proceeds would have been income to Mrs. Carter, they are likewise income to the taxpayers under Section 691. Accordingly, the basis provided in Section 1014(a) is inapplicable.

Taxpayers' argument (Pet. 28–29) is based on a contention that Section 691 does not apply to an unliquidated claim that was uncertain as to right and amount. But Section 1.691(a)–1(b)(3) of Treasury Regulations on Income Tax (1954 Code) (Appendix, *infra*, pp. 14–15) expressly provides that Section 691 covers "Income to which the decedent had a contingent claim at the time of his death." Accord, Rev.

Rul. 55–463, 1955–2 Cum. Bull. 277. This regulation is reasonable and fully consistent with Section 691.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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LOUIS F. OBERDORFER,
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MAY 1962.

APPENDIX

Internal Revenue Code of 1954:

SEC. 691. RECIPIENTS OF INCOME IN RESPECT OF DECEDENTS.

(a) *Inclusion in Gross Income.*—

(1) *General rule.*—The amount of all items of gross income in respect of a decedent which are not properly includible in respect of the taxable period in which falls the date of his death or a prior period (including the amount of all items of gross income in respect of a prior decedent, if the right to receive such amount was acquired by reason of the death of the prior decedent or by bequests, devise, or inheritance from the prior decedent) shall be included in the gross income, for the taxable year when received, of:

(A) the estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent:

(B) the person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the decedent's estate from the decedent; or

(C) the person who acquires from the decedent the right to receive the amount by bequest, devise, or inherit-

ance, if the amount is received after a distribution by the decedent's estate of such right.

(2) *Income in case of sale, etc.*—If a right, described in paragraph (1), to receive an amount is transferred by the estate of the decedent or a person who received such right by reason of the death of the decedent or by bequest, devise, or inheritance from the decedent, there shall be included in the gross income of the estate or such person, as the case may be, for the taxable period in which the transfer occurs, the fair market value of such right at the time of such transfer plus the amount by which any consideration for the transfer exceeds such fair market value. For purposes of this paragraph, the term "transfer" includes sale, exchange, or other disposition, or the satisfaction of an installment obligation at other than face value, but does not include transmission at death to the estate of the decedent or a transfer to a person pursuant to the right of such person to receive such amount by reason of the death of the decedent or by bequest, devise, or inheritance from the decedent.

(3) *Character of income determined by reference to decedent.*—The right, described in paragraph (1), to receive an amount shall be treated, in the hands of the estate of the decedent or any person who acquired such right by reason of the death of the decedent, or by bequest, devise, or inheritance from the decedent, as if it had been acquired by the estate or such person in the transaction in which the right to re-

ceive the income was originally derived and the amount includible in gross income under paragraph (1) or (2) shall be considered in the hands of the estate or such person to have the character which it would have had in the hands of the decedent if the decedent had lived and received such amount.

* * * * *

SEC. 1014. BASIS OF PROPERTY ACQUIRED FROM A DECEDENT.

(a) *In General.*—Except as otherwise provided in this section, the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent shall, if not sold, exchanged, or otherwise disposed of before the decedent's death by such person, be the fair market value of the property at the date of the decedent's death, or * * *.

* * * * *

(c) *Property Representing Income in Respect of a Decedent.*—This section shall not apply to property which constitutes a right to receive an item of income in respect of a decedent under section 691.

* * * * *

SEC. 1231. PROPERTY USED IN THE TRADE OR BUSINESS AND INVOLUNTARY CONVERSIONS.

(a) *General Rule.*—If, during the taxable year, the recognized gains on sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an

exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. For purposes of this subsection—

(1) in determining under this subsection whether gains exceed losses, the gains described therein shall be included only if and to the extent taken into account in computing gross income and the losses described therein shall be included only if and to the extent taken into account in computing taxable income, except that section 1211 shall not apply; and

(2) losses upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of property used in the trade or business or capital assets held for more than 6 months shall be considered losses from a compulsory or involuntary conversion.

* * * * *

Treasury Regulations on Income Tax (1954 Code):

Sec. 1.691(a)-1. *Income in Respect of a Decedent.*— * * *

(b) *General definition.*—In general, the term "income in respect of a decedent" refers to those

amounts to which a decedent was entitled as gross income but which were not properly includible in computing his taxable income for the taxable year ending with the date of his death or for a previous taxable year under the method of accounting employed by the decedent. See the regulations under section 451. Thus, the term includes:

(1) All accrued income of a decedent who reported his income by use of the cash receipts and disbursements method;

(2) Income accrued solely by reason of the decedent's death in case of a decedent who reports his income by use of an accrual method of accounting; and

(3) Income to which the decedent had a contingent claim at the time of his death.

See sections 736 and 753 and the regulations thereunder for "income in respect of a decedent" in the case of a deceased partner.

Sec. 1.691(a)-2. *Inclusion in Gross Income by Recipients.*—(a) Under section 691(a)(1), income in respect of a decedent shall be included in the gross income for the taxable year when received, of—

(1) The estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent;

(2) The person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the decedent's estate from the decedent; or

(3) The person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the

amount is received after a distribution by the decedent's estate of such right.

These amounts are included in the income of the estate or of such persons when received by them whether or not they report income by use of the cash receipts and disbursements method.

* * * * *

Sec. 1.691(a)-3. *Character of Gross Income.*—(a) The right to receive an amount of income in respect of a decedent shall be treated in the hands of the estate, or by the person entitled to receive such amount by bequest, devise, or inheritance from the decedent or by reason of his death, as if it had been acquired in the transaction by which the decedent (or a prior decedent) acquired such right, and shall be considered as having the same character it would have had if the decedent (or a prior decedent) had lived and received such amount. The provisions of section 1014(a), relating to the basis of property acquired from a decedent, do not apply to these amounts in the hands of the estate and such persons. See section 1014(c).

(b) The application of paragraph (a) of this section may be illustrated by the following:

(1) If the income would have been capital gain to the decedent, if he had lived and had received it, from the sale of property held for more than 6 months, the income, when received, shall be treated in the hands of the estate or of such person as capital gain from the sale of the property, held for more than 6 months, in the same manner as if such person had held

the property for the period the decedent held it, and had made the sale.

(2) If the income is interest on United States obligations which were owned by the decedent, such income shall be treated as interest on United States obligations in the hands of the person receiving it, for the purpose of determining the credit provided by section 35, as if such person had owned the obligations with respect to which such interest is paid.

* * * * * *

Sec. 1.691(a)-4. *Transfer of Right to Income in Respect of a Decedent.*—(a) Section 691(a)(2) provides the rules governing the treatment of income in respect of a decedent (or a prior decedent) in the event a right to receive such income is transferred by the estate or person entitled thereto by bequest, devise, or inheritance, or by reason of the death of the decedent. In general, the transferor must include in his gross income for the taxable period in which the transfer occurs the amount of the consideration, if any, received for the right or the fair market value of the right at the time of the transfer, whichever is greater. Thus, upon a sale of such right by the estate or person entitled to receive it, the fair market value of the right or the amount received upon the sale, whichever is greater, is included in the gross income of the vendor. Similarly, if such right is disposed of by gift, the fair market value of the right at the time of the gift must be included in the gross income of the donor. In the case of a satisfaction of an installment obligation at other than face value,

which is likewise considered a transfer under section 691(a)(2), see § 1.691(a)-5.

(b) If the estate of a decedent or any person transmits the right to income in respect of a decedent to another who would be required by section 691(a)(1) to include such income when received in his gross income, only the transferee will include such income when received in his gross income. In this situation, a transfer within the meaning of section 691(a)(2) has not occurred. This paragraph may be illustrated by the following:

(1) If a person entitled to income in respect of a decedent dies before receiving such income, only his estate or other person entitled to such income by bequest, devise, or inheritance from the latter decedent, or by reason of the death of the latter decedent, must include such amount in gross income when received.

(2) If a right to income in respect of a decedent is transferred by an estate to a specific or residuary legatee, only the specific or residuary legatee must include such income in gross income when received.

(3) If a trust to which is bequeathed a right of a decedent to certain payments of income terminates and transfers the right to a beneficiary, only the beneficiary must include such income in gross income when received.

If the transferee described in subparagraphs (1), (2), and (3) of this paragraph transfers his right to receive the amounts in the manner described in paragraph (a) of this section, the principles contained in paragraph (a) are ap-

plied to such transfer. On the other hand, if the transferee transmits his right in the manner described in this paragraph, the principles of this paragraph are again applied to such transfer.

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